

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NORTH CAROLINA

In Re:

David Wayne Guyton

Debtor.

Case No. 98-32966
Chapter 13

~~RECEIVED~~ FEB 10 1999

**ORDER DENYING APPLICATION BY DEBTOR'S ATTORNEY FOR
APPROVAL OF SECURITY INTEREST**

This matter is before the court for hearing on Application by Debtor's Attorney for Approval of Security Interest. The court has concluded that such Application for Approval of Security Interest should be denied.

1. The debtor in this case, David Guyton, retained counsel to represent him in this Chapter 13 proceeding immediately following a foreclosure sale of the debtor's home. Mr. Guyton agreed to pay his attorney a base fee of \$1,300.00 for such representation. As part of said fee, the debtor deposited \$320.00 in the attorney's trust account prior to the filing date of his Chapter 13 petition. Mr. Guyton is expected to pay the remaining \$980.00 over a lengthy period of time through his Chapter 13 plan. Due to the foreclosure sale, time was of the essence, leaving the debtor's attorney no opportunity to investigate the debtor or his ability to pay for services the attorney would render in representing the debtor in a Chapter 13 proceeding. Consequently, in order to secure the payment of the unpaid portion of the base fee and potential future non-base fees, the debtor executed a Promissory Note and granted his attorney a first deed of trust on real estate the debtor owns in Gaston County, North Carolina.

(11)

2. The issue before the court is whether debtor's attorneys should be allowed to take such a security interest in a debtor's non-exempt property prior to filing a bankruptcy petition in order to ensure payment of attorney's fees for representation in a bankruptcy case.

3. To the court's knowledge, no cases exist which discuss this issue in the Chapter 13 context. Although not controlling precedent in this circuit, the above issue has been analyzed in the Chapter 11 context by a small number of courts in other districts. For example, the United States Court of Appeals for the First Circuit in In re Martin, 817 F.2d 175 (1st Cir. 1987), addressed the propriety of an attorney holding a lien against property of the debtor's estate to secure payment of his fees. The First Circuit rejected "a bright-line rule precluding an attorney at all times and under all circumstances from taking a security interest to safeguard the payment of his fee." In re Martin, 817 F.2d 175 at 181. Rather, the court held that the bankruptcy court -- not the debtor or his counsel -- should determine on a case by case basis whether a mortgage or other preferential lien should be allowed to stand in the lawyer's favor. The court offered eleven factors, not designed to be all-inclusive, that a bankruptcy court should take into consideration when making such a determination. See id. at 182.

4. In In re Escalera, 171 B.R. 107 (Bankr. E.D. Wash. 1994), the United States Bankruptcy Court for the Eastern District of Washington rejected the approach outlined in In re Martin and took a very different, more bright-line stance on the issue of an

attorney's holding a security interest in a debtor's property. The Escalera court held that the attorney's taking a pre-filing mortgage to secure post filing services would disqualify him as attorney for the debtor because he would hold an interest adverse to that of the estate and would be ineligible to be employed under 11 U.S.C. § 327(a)¹. See In re Escalera, 171 B.R. 107 at 113 (Bankr. E.D. Wash. 1994).

5. Section 327 does not apply to counsel for a debtor in Chapter 13 or Chapter 7, as neither is a "debtor in possession" standing in the place of a trustee under the Code. 3 COLLIER ON BANKRUPTCY ¶ 327.01, at 327-6 (Lawrence P. King et al. Eds., 15th ed. rev. 1998). Rather, 11 U.S.C. § 330(a)(4)(B) governs payment of debtors' attorneys' fees in the Chapter 13 setting. Section 330(a)(4)(B) provides:

"In a . . . Chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation to the debtor's attorney for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section."

¹According to 11 U.S.C. § 327,

Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants . . . or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

11 U.S.C. § 327.

11 U.S.C. § 330(a)(4)(B). This Code provision primarily governs the reasonableness of the amount of a Chapter 13 attorney's fees but offers no guidance as to whether an attorney should be allowed to take a security interest in debtor's property.

6. Taking the above analysis into consideration, the court concludes that the debtor's attorney's Application for Approval of Security Interest should be denied. The court's ruling falls somewhere between that of the Escalera court's bright-line holding and the Martin court's holding that bankruptcy courts should make a case by case determination as to the propriety of attorneys taking security interest in debtor's property.

7. The court declines to make an absolute prohibition against any attorney in this district from ever taking a security interest in a debtor's property to ensure payment of attorney's fees. Such practice may be approved in exceptional circumstances; and, at a minimum, would require a showing that the debtor would be unable to obtain any legal representation without a security interest in the debtor's property. As the Martin court explained, "[i]t will sometimes be difficult to obtain competent counsel in anticipation of a bankruptcy proceeding unless the lawyer's financial wellbeing can be assured to some extent." Martin, 817 F.2d 175 at 181. No such showing was made in this case. Consequently, the attorney's Application for Approval of Security Interest should be denied.

8. The court would expect it to be a rare case where a debtor was unable to obtain representation because of the favorable treatment given to debtor's attorney's fees by the Code and by the Local Rules for this district. For example, 11 U.S.C. § 503(b)(2)

identifies the "compensation and reimbursement awarded under section 330(a) of this title" as administrative expenses, allowing Chapter 13 debtor's attorneys priority payment of compensation. 11 U.S.C. § 503(b)(2). In addition, the Local Rules for this district provide that the debtor's attorney's fees that are not paid in advance should be paid through the Chapter 13 Plan on an expedited basis.

9. The court concludes, therefore, that the Application by Debtor's Attorney for Approval of Security Interest should be denied.

It is therefore **ORDERED** that:

1. The Application for Approval of Security Interest is denied; and

2. Debtor's counsel shall release the security interest taken in the debtor's property pursuant to his deed of trust.

February 5, 1999.



George R. Hodges
United States Bankruptcy Judge